MINUTES OF THE
CAPITAL PROJECTS AND BOND
OVERSIGHT COMMITTEE

June 25, 1996

The Capital Projects and Bond Oversight Committee met on Tuesday, June 25, 1996, at 1:00 p.m., in Room 129 of the Capitol Annex. Representative Robert Damron, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Robert Damron, Chairman; Senator Charlie Borders; Representatives Jim Maggard, Tommy Todd, and Jim Wayne.

Guests: Bill Hintze, Governor's Office for Policy and Management; Commissioner Armond Russ, Jim Abbott, Jim True, Department for Facilities Management; Don Mullis, Office of Financial Management and Economic Analysis; Camille Bathurst, Harvey Roberts, Kentucky Lottery Corporation; Tom Willis, Department of Education; Marc Matthews, Ross, Sinclaire and Associates; Lori Woodside, Natural Resources and Environmental Protection Cabinet; Sherron Jackson, Council on Higher Education.

LRC Staff: Mary Lynn Collins, Pat Ingram, Scott Varland, Esther Robison.

Representative Todd made a motion to approve as submitted the minutes of the May 30, 1996 meeting. The motion was seconded by Senator Borders and approved.

First on the agenda under New Business were reports on state leases from Mr. Jim Abbott, Director, Division of Real Properties. Mr. Abbott said first to report were the amortization of the cost of agency-requested modifications over the remaining term of 2 existing state leases.

1. PR-3103 - Workforce Development Cabinet (Boone County). Workforce Development requested that the waiting room be enclosed in this leased property (total 3,661 sq. ft. at 7410 US Hwy. 42 in Florence), to improve security and confidentiality. Two written estimates were submitted - $1,812 and $2,376. Workforce Development

Works. The lessor requested that interest at 9.25% be paid on the amortized amount. The lease's expiration date is unchanged on June 30, 1998. Therefore, $2,375.67 plus interest will be amortized over the remaining term of the lease, raising the cost of the lease per sq. ft., according to Mr. Abbott, from $5.14 to $5.20, and the annual cost of the lease from $212,113 to $214,458.

Chairman Damron said lease modifications of less than $50,000 are required be reported to the Committee after execution, but Committee action is not required.

Mr. Abbott also reported the renewal of an existing state lease in Franklin County - PR-2615, which provides 40,945 sq. ft. of office/warehouse space in Fort Boone Plaza (Ash Properties) on Wilkinson Boulevard in Frankfort for the Natural Resources and Environmental Protection Cabinet (NREPC). Mr. Abbott said this lease was last reported to the Committee in June/July 1995 when the Department of Environmental Protection (DEP) proposed the conversion of the old chemical laboratory in the facility to house DEP's biological unit. As an alternative, the Division of Real Properties recommended the biological unit be moved to vacant space in the new state Centralized Laboratory. Mr. Abbott said, due to budgetary constraints, DEP has since decided to retain its biological unit in its existing space in the Ash Properties facility. Currently being reported, he said, was the renewal of the lease contract for 2 years at the current rate per sq. ft. of $7.95, for an annual cost of $325,512.75. He said the chemical laboratory space in the facility is being converted by the lessor into office/warehouse space, including removal of the chemical lab HVAC (heating, ventilation, air conditioning) system and replacement with a conventional HVAC. The lessor has also agreed to install 10 additional 110 electrical outlets and 3 power poles to accommodate office equipment, and to repaint much of the interior and make other minor repairs. The former lab bench-work will remain. Mr. Abbott said this action will allow the Commonwealth to forego maintenance and replacement costs of the lab HVAC, which probably had about 3-5 years left of useful life.

Representative Wayne noted the 1996 General Assembly enacted legislation (HB 264) containing energy efficiency standards for state facilities, and he asked if the new HVAC in this leased facility will meet those standards. Mr. Abbott said the new HVAC will include automatic digital thermostats, which will provide better air quality and will lower utility costs, and there will be dramatic operational cost savings over the previous lab HVAC system which was a 100% air replacement system. He said since the state has leased this facility for about 16 years and much of its mechanical systems are still

Chairman Damron stated that the 1996 General Assembly in the 1996-98 Executive Budget authorized renewal of lease PR-2615 at an estimated cost of $8.95 per sq. ft., or $366,500 annually, so the lease renewal being reported is at a lower cost than that anticipated by the General Assembly. He also noted any lease contract with an annual cost of $200,000 or more must be reported to the Committee before execution, but Committee action is not required.

Ms. Camille Bathurst and Mr. Harvey Roberts of the Kentucky Lottery Corporation were present to report the KLC's planned acquisition of an IBM automated call answering system. Ms. Bathurst said this equipment acquisition was authorized by the 1996 General Assembly for Fiscal Year 1997 [part of the "Data Processing, Telecommunications and Related" equipment pool authorized at $3,350,000 in Agency Funds], and the acquisition will not be finalized until after July 1, 1996. Mr. Roberts said the equipment proposed for purchase is a system for answering a large volume of calls from players and retailers to the Lottery to obtain results from game drawings, and for directing calls to the Lottery's various business units. He said the call volume, depending on the size of game jackpots, runs between 550,000 to 1.2 million calls monthly. In the past, the KLC has leased an automated system from a vendor to handle that volume. At this time, Mr. Roberts said, the KLC has done the analysis and determined the new system, with an initial equipment cost of $415,000, will pay for itself within 2 years and will be very cost-effective. He said, in addition, the KLC intends to use the new system to integrate its phone system and its data systems to enhance the type of service the Lottery can provide to retailers and the public and do it in a more cost-effective way.

In response to questions from Senator Borders, Ms. Bathurst and Mr. Roberts confirmed the current 800-number system costs a minimum of $39,100 per month, depending on volume, and the new call answering system has an up-front, one-time equipment cost of $415,000 and, beginning 2 years after the purchase, a monthly maintenance and support charge of $1,633.64. Senator Borders asked what the life span of the new equipment would be. Mr. Roberts said he estimated it would last 7-10 years. Senator Borders asked, in light of such savings, why the KLC has not made this move before. Mr. Roberts said this proposal was submitted to past administrations of the Lottery, but was turned down. Senator Borders made a motion to approve the proposed equipment purchase; the motion was seconded by Representative Maggard.

Mr. Roberts said there were 4 employees in the Customer Service Unit, plus a receptionist, and all of the staff assist in a "ring down" system. Representative Wayne asked if any of these employees will be laid off after the new system is in place. Mr. Roberts said it is the KLC's intent to use those employees elsewhere in the Lottery Corporation.

Chairman Damron said this new system seems to follow the philosophy of EMPOWER Kentucky, that is, to use technology to improve the efficiency of government. He asked if the Lottery would qualify for EMPOWER Kentucky funding to cover the new phone system. Ms. Bathurst said the KLC assumed that because it generates its own revenue it would not be appropriate to ask for revenue from other sources to fund this expenditure. Chairman Damron said the Committee's staff agreed the KLC probably would not qualify for EMPOWER Kentucky; he said the new call answering system certainly seems to agree with the EMPOWER Kentucky philosophy, which may be why the KLC's current administration looked on the proposal with more favor.

There being no further discussion on the motion to approve the equipment purchase, the motion was adopted by unanimous voice vote.

Next on the agenda were bond activity reports submitted by the Office of Financial Management and Economic Analysis (OFMEA). Mr. Don Mullis, Executive Director of OFMEA, was present to report new School Building Revenue Bonds, Series 1996, with state funding through School Facilities Construction Commission (SFCC) participation in annual debt service payments, for the following school districts:

a. Estill County - with gross proceeds of $8,875,000, to construct a new middle school. Annual SFCC debt service participation of $44,932 and locally-funded debt service of $750,435.

b. Fayette County - Series A with gross proceeds of $18,050,000, to fund renovation of 3 middle schools. Annual SFCC debt service participation of $61,843 and locally-funded debt service of $1,360,617. Mr. Mullis said Fayette County Series B and C bonds, both issues 100% locally-supported, will be sold with this SFCC-assisted issue. (See below.)

c. Harlan County - with gross proceeds of $9,995,000, to construct a new high school at Evarts. Annual SFCC debt service participation of $138,900 and locally-funded debt service of $815,000.

f.Washington County - with gross proceeds of $1,790,000, to fund renovations at the high school. Annual SFCC debt service participation of $16,831 and locally-funded debt service of $124,570.

Mr. Mullis said none of the new issues required an increase in local school tax rates. Bond Payee Disclosure Forms and additional preliminary information for each proposed new bond issue were provided. Representative Wayne made a motion to approve the 6 SFCC-assisted school bond issues. The motion was seconded by Representative Todd and approved by unanimous voice vote.

Also reported was the proposed issuance of School Building Revenue Bonds, Series 1996, with 100% locally-funded debt service and no SFCC debt service participation, for:

a. Fayette County - Series B bonds, with gross proceeds of $20,190,000, to construct 2 elementary schools and one middle school.
b. Fayette County - Series C, with gross proceeds of $2,000,000, to fund technology infrastructure at several schools.
c. Owensboro Independent (in Daviess County) - with gross proceeds of $820,000, to complete a preschool addition at Foust Elementary.

Bond Payee Disclosure Forms and additional preliminary information for each bond issue were provided. Chairman Damron said the Committee's staff had reviewed these 3 bond issues and found that all required information has been provided, and there are no local school tax rate increases associated with the bond issues. Bond payee information must be provided for locally-funded school bonds prior to issuance, but Committee action is not required.

Chairman Damron said a late addition has been made to today's agenda: a proposed issuance of Tax and Revenue Anticipation Notes by the Kentucky Interlocal School Transportation Association (KISTA). He said this locally-supported debt issuance would not require action by the Committee, but because it is an unusual issuance he thought members would have questions. Mr. Marc Matthews of Ross, Sinclaire and Associates said his firm is the financial advisor to KISTA for this proposed note issuance. He said KISTA is a consortium of school districts in the state and its board is comprised of 15 school superintendents from around the state. He said KISTA primarily provides funding programs for school districts that are done more costidentical to a program the Kentucky League of Cities operates for Kentucky cities where they pre-fund tax receipts and revenues anticipated from state and federal programs. TRAN is a very short-term note program; the borrowing commences at the first day of the fiscal year, July 1, 1996, and must be repaid by the end of the fiscal year, June 30, 1997, so there is no roll-over effect. He said, at this time, 44 of the state's school districts - which is 25% of the total number of districts - plan to participate in the TRAN note issuance, for a combined borrowing of approximately $60 million. He said the proposed program has been reviewed by bond and tax counsel from 2 state bond counsel firms; it also has been reviewed by Standard and Poor's, the bond rating firm, and has been assigned its highest short-term rating of "SP1." He noted that a portion of the school districts that are particularly financially sound have been given an "SP1+" rating.

Representative Maggard asked what the interest rate will be on the short-term notes. Mr. Matthews said, like any other school bond sale, the issuance will be competitively bid which is scheduled for July 1; it would be a one-year tax-exempt note rate and he estimated it would be in the 4% range. He said it would be a very favorable rate to districts who need to pre-fund their expenses in anticipation of tax receipts and state or federal funds. Representative Maggard said he wished a similar program were available for county governments, noting that Breathitt County is in financial straits and is paying 10-12% interest on loans from local banks. Mr. Matthews said that the League of Cities has a program for city governments and the Kentucky Association of Counties (KACO) would probably be the organization that would have such a program for county governments. He noted the Breathitt County School District is one of the 44 planning to participate in the KISTA program.

Chairman Damron asked if school districts who do not need the funds right now will be able to reinvest the funds at a higher rate of return and access interest earnings. Mr. Matthews stressed that, to meet IRS requirements, each district must be "qualified" through a cash flow analysis of their monthly expenditures, to determine if they do spend down below their cash balance prior to receipt of local tax dollars or if they do pre-fund state and federal programs prior to reimbursement. He said each of the 44 districts identified qualified for TRAN. He said the KISTA qualification process also determines the maximum amount in any one period a district pre-funds, which determines the amount a district can borrow.

Mr. Matthews said that, while KISTA will be bidding the note rate, it will also be the loss of interest they have on their general fund balances. A second option is to draw funds down when deficits arise and use the program in lieu of drawing from the general fund, in which case districts will have borrowed at a favorable rate and can continue to keep their general funds deposited in local banks. The third option for districts is to draw their funds down and invest them locally. Districts will know on July 1 what the interest earning will be if they leave their money in the KISTA reinvestment.

Chairman Damron said, then, school districts can use their funds to invest them to make money through an interest differential, or they can use them to fund specific needs. He asked Mr. Matthews to confirm that a district that is cash rich, has a carryforward from year to year, and uses its balance to pay down until it receives tax revenue, will be able to use this mechanism to generate interest income. Mr. Matthews said that is correct; it is considered a new source of revenue and a way to recapture interest income that is lost when a district's general fund must be used to pre-fund tax receipts or other anticipated revenues.

Chairman Damron asked, if a specific district defaults on its notes, who pays for it and what is the liability of other participating districts. Mr. Matthew said that, while this is a "pool" program, it is structured so that there is no cross-liability between districts; each participating district is advertised for its own amount and bids are accepted as if there were 44 separate note issues. He said Ross, Sinclaire considers this to be an important point because one district's loss cannot be allowed to affect other districts who have performed correctly. He said there are 2 sources of potential loss. First, if the funds are reinvested in improper investments, there could be a loss. For that reason, he said, the requirements of the permissible investments of the state are invoked, and investment will be primarily in guaranteed US Treasury notes. They will be competitively bid, and the quality of the investment as well as the rate returned will be part of the selection criteria districts will use in determining what to do with their funds. With regard to the other potential loss, he said, part of Standard and Poor's rating process is an analysis of each district's state funding for the last quarter of the year; districts must have 125% to 150% coverage of future state revenue on any amount they borrow, and if a district willfully chooses not to repay on its notes, it is anticipated the state funding intercept provisions may be applied. He said the potential for interception of SEEK moneys, state education funds that go to districts, is a similar concept as applied to all school bond issues, and to which the Standard and Poor's and Moody's rating agencies have readily agreed.

Department has had discussions with both of the fiscal agents involved in this, but has not issued a letter endorsing the program because the Department has some questions about whether the SEEK intercept provisions would apply. He said the language in the statutes on the intercept provision talks specifically about buildings and bonds sold for buildings, so Education staff has questioned its application here. He said Kevin Noland, Associate Commissioner, Office of Legal Services, Department of Education, has not formally put a legal opinion in writing stating the Department's position either way. He said Mr. Noland is on vacation and could perhaps be called in to address this. He said he was aware that Mr. Noland, in the past, has questioned the application of the intercept provision in anything other than a bond issue for a building.

Chairman Damron said it appeared to him that this issue should be cleared up so investors in this process will know without any doubt whether the intercept provision is going to be part of the program. He said, as chair of this Committee, he is concerned that anything that has the Commonwealth of Kentucky's name on it be solid. While the state may have no legal or moral obligation to repay these notes, he said, he believes anything that has Kentucky's name on it reflects on Kentucky's government and its people. He said this may be a very innovative way of providing additional revenue for school districts and bond counsel, but he is concerned that everything be in order to protect everyone involved. Mr. Matthews said he absolutely agreed; his understanding was that this issue was tied down, and he would make sure that it is settled. Chairman Damron asked if it could be tied down before these notes are advertised or sold. Mr. Matthews said he thought the advertisement had already taken place, but it is necessary that it be addressed before the notes are sold. He said he was certain it has been represented to Standard and Poor's that the intercept applies.

Chairman Damron said we should establish clearly whether the SEEK intercept provision will apply here, but he also expressed concern about the potential for a similar funding tool being created for county governments through the Kentucky Association of Counties (KACO). He said he is concerned that if county governments have this option, current administrations may be inclined to obligate the next fiscal year's revenues for notes to fund projects and programs for which they can get credit, and then new and different administrations may come into office and find all of their revenues are already obligated.

Representative Wayne said he is very concerned if SEEK funds are involved in this proposal, because it then becomes a legislative matter since the General Assembly will manage the funds initially in a trustee capacity for note holders. On the day the notes are sold, each local district will have their share of the composite pool deposited in their account with Fifth Third Bank. Then, he said, districts will know the rate their funds will earn if they remain on deposit with the trust account, and they will be able to leave their funds there or deposit them locally if they wish.

Representative Wayne asked if banks were given the option to bid as trustee. Mr. Matthews said he believed there were 8 recognized statewide trust banks and all had the opportunity to participate in an open bidding process. He said educational meetings were held for the banks in February, and he believed there were initially 3 bidders but one withdrew. He said some institutions were reluctant to bid upon learning they potentially might have to set up a separate account for each district and wire funds to districts and take deposits back on a line-of-credit basis daily. He said he expected interest in bidding will pick up after the program has a year's history and potential trustees have a better idea of how much work is actually involved. He said there definitely is interest on behalf of institutions in having a presence in every school district in the state.

Representative Wayne expressed appreciation for Mr. Matthews' efforts on behalf of school districts, but said he wanted to re-emphasize his concern about the SEEK funds. He said that may be an issue the General Assembly has to address legislatively, and he believed the SEEK funds were something the General Assembly takes very seriously. He said he hoped the applicability of the SEEK intercept for the TRAN program would be worked out very carefully, and that there be legislative consultation, if not legislative action, to either endorse it or say the General Assembly is not going to participate. Mr. Matthews guaranteed Representative Wayne he will begin working on this question immediately.

Mr. Willis said the Department of Education's concern is that in 1994 the General Assembly specifically provided for the SEEK intercept so that SEEK funds could be captured if a school district was not making regular bond payments, and the statute refers specifically to buildings. He said he did not believe Education had any concerns about the TRAN program itself, once the legality and what it will do for districts are established. He said the Department of Education was concerned that it might become involved if a district did not make its payments, and the Department thought clarification was needed on the intercept provision. He noted that Jefferson County is not participating in KISTA's program, but intends to do its own separate issue.

of Education had not been involved or had not reviewed or offered some approval. Chairman Damron said the Committee would ask that Education and its counsel look very closely at the statutory language.

Chairman Damron thanked Mr. Matthews for attending and Mr. Matthews said the Committee made excellent points on issues that need to be tied down.

Chairman Damron noted that OFMEA also provided monthly and weekly debt issuance calendars for the Committee's information.

Next on the agenda was the monthly project report from the Finance and Administration Cabinet. Mr. Bill Hintze, Governor's Office for Policy and Management, and Mr. Armond Russ, Commissioner, Department for Facilities Management, were present. Mr. Hintze said the single item reported today involves an advance of $16,000 from the state's emergency repair, maintenance and replacement account to assist in funding a project to correct deficiencies in the sewage treatment plant at the Woodsbend Boys' Treatment Center Facility in West Liberty, Morgan County. The Natural Resources and Environmental Protection Cabinet has cited the sewage treatment facility as inadequate. Mr. Hintze said the Cabinet for Families and Children initiated the project with $83,000 from its maintenance fund; however, the low bid on the project came in at $98,794.61, leaving a shortage of just under $16,000. Since this is the last month of the fiscal year and the Cabinet has depleted its maintenance pool, he said, Finance Secretary John McCarty approved the Cabinet's request for emergency supplemental funding to allow acceptance of the low bid so the project can proceed. Mr. Hintze said the Cabinet for Families and Children will be required to repay this advance when its maintenance pool is replenished on July 1, 1996 for the upcoming fiscal year, as was also the case for emergency account advances to 2 other urgent Cabinet projects reported to the Committee at the May meeting.

Chairman Damron noted that allocations from the emergency account are required to be reported to the Committee within 30 days, but Committee action is not required.

In other business, Chairman Damron said that as of June 30 the Committee will be losing 2 of its members - Senator Jeff Green, who has served as chairman and vice chairman for the Committee, and Senator Charlie Borders. He said both Senator Green and Senator Borders have given great service to the Committee, and both have raised

Senator Borders said that, in his 6 years in the legislature, the highlight has been serving on this Committee. He said he believes a committee never rises above the leadership of its chairman, and Chairman Damron and his predecessors have been legislators who were dedicated to doing the people's business. He said he also believes a committee's leaders can be only be as good as the members making up the committee, and a committee's members and its chairman can only be as good as its staff. He said he regrets having to leave this Committee, but his charge to the members remaining would be that the Committee continue, as it has done until now, to operate in a non-partisan manner and to address the people's business. Chairman Damron and the other members thanked Senator Borders for his comments and said the Committee will miss him in the future.

Chairman Damron said the LRC at its June 5 meeting appointed 2 new members to the Committee, Senator Denny Nunnelley and Senator Tom Buford, effective July 1, to fill the 2 vacated seats. He said the 5 remaining members of the Committee also were reappointed to new 2-year terms effective July 1, 1996.

Chairman Damron said the Committee's July meeting would be held as scheduled on Tuesday, the 23rd, at 1:00 p.m. He suggested that members consider and let the Committee know if they have any specific project or issue they would like the Committee to look at during this interim. He also suggested that members or Mr. Hintze let him know if they had any ideas on state facilities the Committee might consider visiting during this interim, noting legislative committees are still limited to 2 out-of-Frankfort meetings per interim.

There being no further business to come before the Committee, the meeting was adjourned at 2:00 p.m.